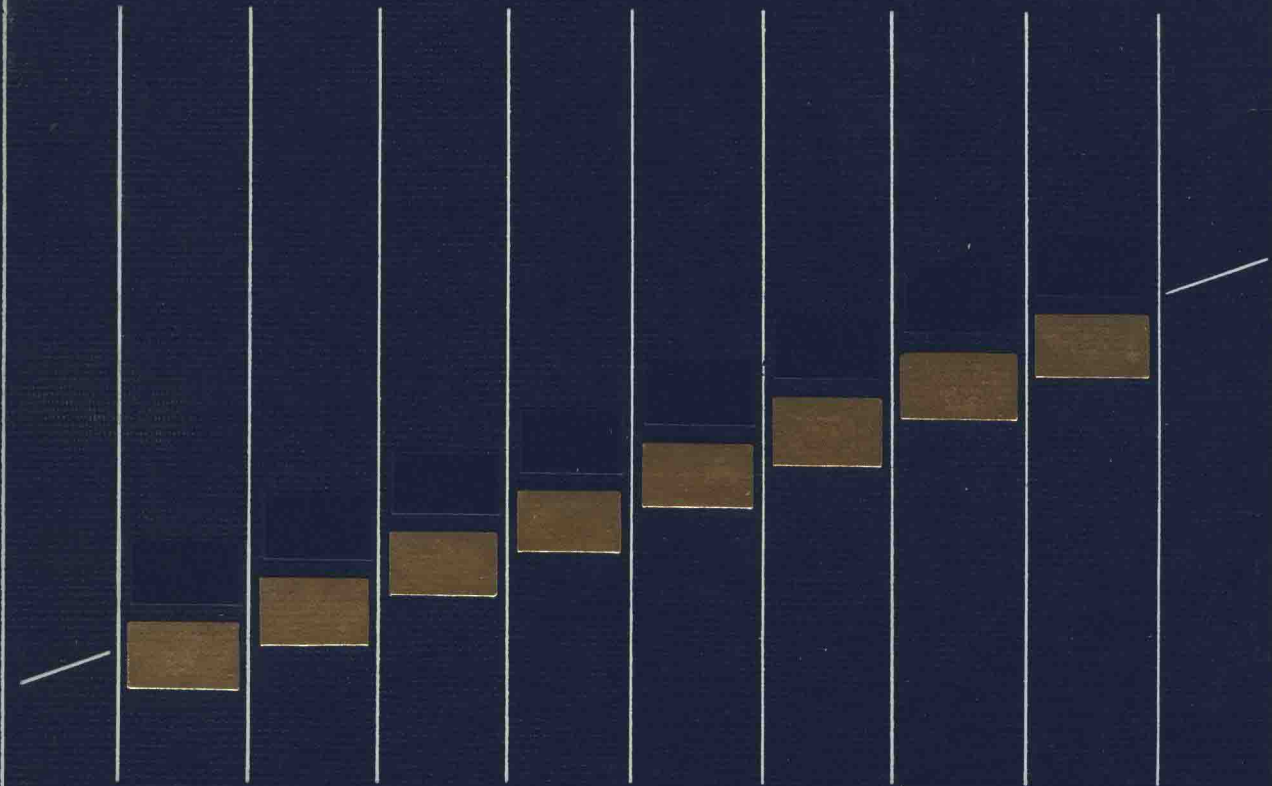


COMPENSATION



Milkovich | Newman

Second Edition

Compensation

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1987 Second Edition

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Compensation

Preface

Compensation is a fascinating subject. Everyone suspects it is determined without apparent justice. No one is indifferent to the subject, particularly when their own pay is being discussed. In addition to this inherent fascination, we are in a period when traditional approaches to pay determination are increasingly challenged and scrutinized.

Faced with serious economic pressures to improve productivity, boost the quality of products and services, and control labor costs, as well as social pressures from shifting employee expectations and continued government regulations, managers are reexamining their approaches to pay determination. They need to better understand how to design and manage the compensation their employees receive. As a result traditional, often bureaucratic, approaches are being reexamined. In some instances different approaches, some new and some simply old goods in new wrappings, are being tried. Often the current approach is retained but becomes better understood and managed after being reexamined.

This process of creative reexamination is both a boon and a source of frustration for compensation managers. On the positive side, compensation managers have the opportunity to make decisions that dramatically affect their organizations. Pay decisions can be integrated into the entire strategic management process. Compensation policies can facilitate effective work behaviors, support equitable treatment of employees, and accomplish organization objectives.

These opportunities can also be a source of frustration. Very simply, compensation management can no longer be managed from a limited approach. Pursuit of the single correct technique is futile. Multiple answers are more or less viable depending on the characteristics of both the organization and its environment.

About this Edition

The design of this book is largely based on four strategic choices involved in managing compensation systems. As the compensation model in Chapter 1 illustrates, these strategic choices include concerns for internal consistency (inter-

nal equity), external competitiveness (external equity), employee contributions (employee equity), and the process of administration. Four sections in this book examine each of these strategic decisions and discuss the major compensation issues requiring resolution. These discussions are placed in the context of related theories, research, and state-of-the-art practices that can guide compensation decision making.

Additional chapters of this book cover employee benefits, government's influences on compensation, pay discrimination, and unions' role in pay administration. These are topics of continuing importance. First, costs of employee benefits have escalated rapidly, and employers are taking significant steps to contain these costs by modifying benefit programs. Employees are also increasingly able to choose various benefits tailored to their individual circumstances. Next, the government's role is considered in terms of its direct and indirect effects on pay. Directly, government is a regulator of pay decisions through legislation and the courts (e.g., minimum wage, pay discrimination, and comparable worth). Indirectly, through its fiscal and monetary policies (e.g., tax laws and stimulating the economy), the government affects the supply and demand for labor and, hence, compensation decisions. The changing yet critical role unions play in compensation management is also examined in a separate chapter and throughout the book.

This book undertakes three central tasks. The first is to examine the current theory and research related to managing compensation. This analysis is supported by extensive up-to-date references in each chapter.

The second task is to examine the changing state of compensation practice. Here we draw upon practices actually used by wide variety of employers and consulting firms. These practices illustrate new developments as well as the established approaches to compensation decisions.

Finally, this book provides an opportunity for you to develop your own decision-making skills through a series of exercises based on actual experiences. These exercises emphasize using concepts and techniques. A workbook with more extensive cases and computer applications is also available. Completing these exercises will help you develop skills readily transferable to future jobs and assignments.

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George T. Milkovich
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Chapter 1

Strategic Issues and the Pay Model

Chapter Outline

COMPENSATION IN CONTEMPORARY SOCIETY

FORMS OF PAY

A PAY MODEL

- Compensation Objectives

- The Four Basic Policy Decisions

- Balancing Consistency, Competitiveness, Contributions, and Administration

- Pay Techniques

STRATEGIC ISSUES

- The Pay System and the Organization's Strategic Conditions

- The Pay System and the Organization's Culture and Values

- The Pay System and Employee Needs

- The Pay System and Unions

BOOK PLAN

SUMMARY

Think of an employer, any employer—from Burlington Northern Railroad to Ralph's Pretty Good Groceries—and consider the array of wages paid. Burlington Northern's wages differ for different jobs ranging from locomotive engineers, to laborers on maintenance-of-way gangs, accountants, traffic clerks, and nurses. Similarly, Ralph's pays checkout clerks, produce department managers, and butchers.¹

Why do some employers pay more (or less) than other employers? Why are different jobs within the same organization paid differently? And why do different workers doing the same job for the same employer receive different pay?

¹Garrison Keillor, *Lake Wobegon Days* (New York: Viking Press, 1985).

How are these decisions made and who is involved in making them? What are the consequences of these decisions for both the employer and the employee? These questions were so interesting to Mary Lemons, a Denver nurse, that she took her employer, the city of Denver, to court, alleging that it was illegal to pay Denver's tree trimmers (all men) more than its nurses (mostly women).² Compensation, whether it's your own or someone else's, is a fascinating topic.

Compensation professionals are immersed in one of society's greatest challenges: the efficient and equitable distribution of the returns for work. As already noted, compensation decisions are many and varied. They include how much to pay people who perform both similar and different types of work; whether to use pay to recognize variations in individual employees' experience and/or performance; and how to allocate pay between cash and benefits and services. Such basic decisions must be made by every employer, no matter how large or small. Further, these decisions must be consistent both with society's changing values about what constitutes fair and equitable pay and with government legislation and regulations. Consequently, decisions about compensating people for the work they perform are increasingly complex, as are the skills required to make those decisions.

This book is about the management of compensation—the decisions that go into paying employees; the concepts and research underlying those decisions; the alternative techniques used to help make decisions; and the objectives obtained. Its purpose is to give you the background required to make these pay decisions. Let us start with what is meant by compensation.

COMPENSATION IN CONTEMPORARY SOCIETY

Perceptions of compensation vary. Some in *society* may see it as a measure of equity and justice. Others may see high pay as a cause of U.S. firms' inability to meet foreign competition. Still others may see it as an underlying cause of tax increases. For example, a comparison of 1984 median weekly earnings of fully employed women (\$268, or 66 percent) with that of men (\$404) highlights apparent inequities in pay decisions, which many consider an indication of discrimination against women.³ To consumers, the fact that production workers in South Korea earn, on average, 11 percent (\$1.29) of their U.S. counterparts' hourly pay (\$12.26) is the root of U.S. manufacturing competitive problems.⁴ Some voters also see compensation as the cause of increased taxes (wages for teachers and public employees) and inflation (wage settlements negotiated by

²*Lemons v. City and County of Denver*, 620 F.2d 228 (1980).

³"The Wage Gap," in *Comparable Worth: An Analysis and Recommendations*, a Report of the United States Commission on Civil Rights, June 1985; June O'Neill, "The Trend in the Male-Female Wage Gap in the United States," *Journal of Labor Statistics* 3 (1985), pp. S91-S116.

⁴Joyanna Moy, "Recent Trends in Unemployment and the Labor Force, 10 Countries," *Monthly Labor Review*, August 1985, pp. 9-22; and "Sky-High U.S. Wages May Hurt Competitive Stance," *Compensation and Benefits Review*, November-December 1985, pp. 4-5.

unions). Public policymakers and legislators may view income differences as guides for adjusting entitlements and transfer payments (social security, aid to dependent children, and the like).

In contrast to the societal perspectives, *employees* may see compensation as a return for services rendered or as a reward for satisfactory or meritorious work. Compensation to some reflects the value of their personal skills and abilities, or the return for the education and training they have acquired. The pay individuals receive for the work they perform is usually the major source of personal income and hence a vital determinant of an individual's economic and social well-being.

Managers also have a stake in compensation; they view it from two perspectives. First, it is a *major expense*. Studies show that in many enterprises labor costs account for more than 50 percent of total costs.⁵ Among some industries, such as service or public employment, this figure is even higher. Recent studies report that labor costs as a percent of total costs vary even among individual firms within one industry. This has led some to conclude that compensation practices can offer some firms a competitive advantage in their industry.⁶

In addition to viewing compensation as an expense, a manager will also view it as a possible *influence on employee work attitudes and behaviors*.⁷ Compensation may affect an individual's decision to apply for a job, to work productively, to organize a union, to take the employer to court, or even to undertake more training for a new job. This potential to influence employees' work attitudes and behaviors is an important rationale for ensuring that compensation is managed fairly and equitably. These contrasting perspectives of compensation—societal, individual, and managerial, each with different stakes in compensation decisions—can account for the relevance of the topic. But these perspectives can also cause confusion if not everyone is talking about the same thing. So let's define what we mean by compensation.

FORMS OF PAY

Compensation, or pay (the words are used interchangeably in this book), is defined in the following terms:

Compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship.

⁵Ira T. Kay and Martin Leshner, *Human Resource Costs and Business Strategy: Striving for Competitive Advantage in the Pharmaceutical Industry* (New York: The Hay Group, 1986).

⁶Ibid.

⁷Edward E. Lawler III, *Pay and Organizational Development* (Reading, Mass.: Addison-Wesley Publishing, 1981).